

Message Text

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PAGE 01 LONDON 04118 01 OF 03 161852Z

43

ACTION EUR-12

INFO OCT-01 EA-07 NEA-10 ISO-00 SP-02 USIA-06 AID-05 EB-07

NSC-05 CIEP-01 TRSE-00 SS-15 STR-04 OMB-01 CEA-01

CIAE-00 COME-00 FRB-03 INR-07 NSAE-00 XMB-02 OPIC-03

LAB-04 SIL-01 L-03 H-02 PA-01 PRS-01 ARA-06 AF-06

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LIMITED OFFICIAL USE SECTION 01 OF 03 LONDON 04118

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TAGS EFIN, UK

SUBJECT: EUROCURRENCY MARKET DEVELOPMENTS

REF: LONDON 17558

SUMMARY: BANKERS REPORT INCREASING ATTENTION TO QUALITY OF BORROWERS, WITH DOWNWARD PRESSURE ON SPREADS AND FEES FOR FIRST-RATE BORROWERS, INCREASING DIFFICULTY AND WIDER SPREADS FOR THE LESS FAVORED. END SUMMARY

1. BANKERS HERE INDICATE THAT FIRST-CLASS BORROWERS IN
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PAGE 02 LONDON 04118 01 OF 03 161852Z

MEDIUM TERM SYNDICATED BANK CREDITS WILL PROBABLY CONTIN-

UE TO SEE BORROWING TERMS SOFTEN FOR THEM. THIS WILL BE REFLECTED IN LENGTHENING OF MATURITIES, POSSIBLY A BREAK IN THE CURRENT MINIMUM SPREAD OF 1-1/4 PERCENT FOR 3 TO 5 YEAR LENDING FOR TOP-RATED COMMERCIAL AND SOVEREIGN BORROWER RISKS AND A REDUCTION OF FEES. A HIGH QUALITY BORROWER COMING TO THE MARKET FOR THE FIRST TIME CAN FORCE VERY SHARP TERMS. AUSTRIAN GOVERNMENT 7-YEAR ISSUE AT 1-1/4 OVER LIBO AND CURRENT EC BORROWING PACKAGE CITED AS EXAMPLES, BUT BANKERS CLAIM THAT SECOND ISSUE BY SAME BORROWER COULD BE MORE EXPENSIVE AND HARDER TO PLACE. IN GENERAL, LENDING BANKS ARE MORE WILLING TO MAKE CONCESSIONS ON FEES THAN ON SPREADS. IN PART BECAUSE OF LESS EAGERNESS TO BOOST INITIAL EARNINGS WITH HIGH FRONT-END FEES WITH THE CONCOMITANT OF LOW SPREAD ASSETS OVER SEVERAL YEARS.

2. WHEREAS THE SITUATION LOOKS BETTER FOR THE "TRIPLE A" RATED BORROWERS, IT IS IF ANYTHING TIGHTENING FOR LESS THAN PRIME BORROWERS. ONE INDICATION CITED IS THE COMECO BANK INTERNATIONAL INVESTMENT BANK BORROWING OF 600 MILLION DOLLARS ON WHICH THERE IS A FULL ONE PERCENT FEE, IN CONTRAST TO THE 3/8 PERCENT FEE CHARGED ON ITS EARLIER BORROWING. BANKERS REPORT THE FEE WAS DESIGNED TO YIELD, IN CONNECTION WITH THE SPREADS, A 1-1/2 PERCENT ANNUAL RETURN. RUSSIANS BALKED AT A 1-1/2 PERCENT SPREAD. BECAUSE THIS COULD HAVE BEEN TAKEN BY MARKET AS SIGN OF WEAKENED CREDIT POSITION' BUT ACCEPTED PAYING THE HIGHER FEE. BANKERS SAY USSR ALSO IS USING COMECON BANK VEHICLE AS FACE-SAVING DEVICE, RATHER THAN BORROW AT HIGHER COST IN ITS OWN NAME. US COMMERCIAL BANKS AND EUROPEAN CONSORTIA BANKS CITE MORE CAUTIOUS ATTITUDE TOWARD LENDING TO THE EASTERN BLOC. ONE BANKER SAID HUNGARY IS RECEIVING SHARP SCRUTINY FROM LENDERS.

3. BANKERS ALSO REPORT THEY ARE MUCH MORE WARY OF CERTAIN SOVEREIGN RISKS INCLUDING BRAZIL, WITH SPREADS ON BRAZILIAN STATE PAPER INCREASING 1/8 TO 1/4 TO THE 1-7/8, 2, 2-1/8 PERCENT RANGE. RECENT SAO PAULO AND STATE OF BAHIA SYNDICATED ISSUES WENT POORLY, LEAD BANKS HAVING TO ABSORB UP TO 50 PERCENT. THE DIFFICULTIES OF ZAIRE, NORTH KOREA, LIMITED OFFICIAL USE

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PAGE 03 LONDON 04118 01 OF 03 161852Z

AND ARGENTINA ARE FREQUENTLY CITED. OTHER BORROWERS BEING VIEWED MORE CRITICALLY ARE PHILLIPINES, PERU, MALAYSIA, AND POSSIBLY MEXICO. VARIOUS EUROMARKET CONFERENCES OVER THE PAST 2 MONTHS HAVE CITED THE LIKELIHOOD OF FORTHCOMING RESCHEDULING OF CERTAIN LDC EURO CURRENCY DEBT SERVICE OBLIGATIONS. WHEREAS NON-OIL DEVELOPING COUNTRIES RAISED NEARLY 9 BILLION DOLLARS IN EURO CURRENCY CREDITS LAST YEAR, ONE MAJOR US BANK HERE REPORTS THAT BANKING

COMMUNITY CONCERNS OVER INTERNAL LENDING LIMITS IMPLY THAT CONSIDERABLY LESS FUNDS WILL BE AVAILABLE TO THIS CATEGORY OF BORROWER DURING 1976. IN TURN, THIS ATTITUDE ON THE PART OF MANY BANKS LEADS SOME MARKET COMMENTATORS TO THE CONCLUSION THAT RESCHEDULING OF SUBSTANTIAL AMOUNTS OF NON-OIL LDC DEBT IS ALL BUT INEVITABLE EITHER THIS YEAR OR NEXT. NOT ALL BANKERS AGREE WITH THIS ASSESSMENT, GIVING AS RATIONALE THE POSSIBILITY OF LDCS BORROWING FROM INTERNATIONAL FINANCIAL INSTITUTIONS AS A MEANS OF AVOIDING RESCHEDULING.

4. IN ADDITION TO COUNTRY RISK, MANY BANKS CITE INDUS-

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PAGE 01 LONDON 04118 02 OF 03 161856Z

43

ACTION EUR-12

INFO OCT-01 EA-07 NEA-10 ISO-00 SP-02 USIA-06 AID-05 EB-07

NSC-05 CIEP-01 TRSE-00 SS-15 STR-04 OMB-01 CEA-01

CIAE-00 COME-00 FRB-03 INR-07 NSAE-00 XMB-02 OPIC-03

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LIMITED OFFICIAL USE SECTION 02 OF 03 LONDON 04118

TRIAL SECTOR LIMITATIONS AS A FURTHER RESTRAINING FACTOR. LONDON PROPERTY MARKET LOANS, REIT'S, TANKER LOANS AND SHIPBUILDING YARD LOANS ARE KNOWN PROBLEMS. EXTENT OF BANKS POTENTIAL LOSSES FROM LONDON PROPERTY MARKET IS JUDGED PRETTY WELL FIXED, AND SOME SAY FULL EXTENT OF LOSSES IN OTHER THREE CATEGORIES, WHILE NOT CERTAIN, WILL BECOME BETTER KNOWN DURING 1976. THERE IS SOME FEAR THAT NEW YORK CITY COULD AGAIN POSE PROBLEMS IN COMING MONTHS. CONTAINER SHIPS, WITH RUSSIAN FLEET WELL IN EXCESS OF USSR'S OWN NEEDS, CITED AS AREA IN WHICH LENDERS ARE LIMITED OFFICIAL USE

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PAGE 02 LONDON 04118 02 OF 03 161856Z

CAUTIOUS. UP TURN IN WORLD ECONOMY AND INDUSTRIAL PROFITS SEEN GIVING BETTER TONE TO CORPORATE SECTOR LENDING. SOME US BANKS BEGINNING TO MORE ACTIVELY EXPLORE STERLING LENDING POSSIBILITIES. LARGE FINANCINGS ARE EXPECTED THROUGHOUT YEAR FOR NORTH SEA DEVELOPMENT. FOR ONE RESPECTED OVERALL ASSESSMENT, SEE LONDON A-1027 OF DECEMBER 8, 1975.

5. IN SYNDICATED BANK OPERATIONS, SOME OPERATORS CONSIDER THERE IS A CLEAR DICHOTOMY BETWEEN THE LONDON MARKET AND THE CONTINENTAL MARKET. ONE SPECIALIST SAYS LONDON DEALS TEND TO BE MORE ORIENTATED TOWARDS EASTERN AND WESTERN EUROPE FOR DIRECT GOVERNMENT BORROWINGS. CONTINENTAL MARKET DEALS TEND TO CONTAIN GREATER ELEMENTS OF CLIENT RELATIONSHIP AND EXPORT SUPPORT. STRUCTURING AND PRICING OF CREDITS THEREFORE CAN BE QUITE DIFFERENT. LOANS TO MEET CONTINENTAL EUROPEAN BANKS CRITERIA CAN IN MANY CASES BE MORE FINELY PRICED THAN DEALS IN THE LONDON MARKET. CO-MANAGERS OF THESE LARGE ISSUES WILL THEREFORE STRUCTURE AND PRICE ACCORDING TO EITHER LONDON BANKS' INTERESTS OR CONTINENTAL BANKS' INTERESTS. WHEREAS LONDON REMAINS THE MAJOR SYNDICATED EUROLOAN CENTER, SOME BANKERS REPORT A SHIFTING OF DECISIONMAKING FROM LONDON IN THE DIRECTION OF THE ULTIMATE BORROWER. CONTINUING DIVERSITY OF MARKET CHARACTERISTICS IS CITED.

6. BANKERS REPORT CAPITAL ADEQUACY IS LESS A CONSTRAINT NOW THAN 12 MONTHS AGO, BUT THEY EXPECT THIS COULD CHANGE GIVEN UPTURN IN BUSINESS CYCLE. WEAK LOAN DEMAND IN US AND AMPLE AVAILABILITY OF BOUGHT FUNDS IN INTERBANK EUROMARKETS SEEN AS FACTORS IN LIQUIDITY SITUATION. SYNDICATED EUROCURRENCY MARKET TERMED ADEQUATE TO QUITE LIQUID FOR GOOD BORROWERS AND CREDIT RISKS. EC ISSUE CITED AS AN EXAMPLE.

7. CONTINUING OPEC DEPOSITS ALSO CITED, ESPECIALLY FROM SAUDI ARABIA AND KUWAIT. SUBSTANTIAL DEMAND FOR MEDIUM-TERM EUROLOANS FROM OTHER OPEC MEMBERS IS EXPECTED TO CONTINUE IN 1976 AND 1977. IRAN, VENEZUELA, ALGERIA SEEN AS ENERGY PRODUCERS WHICH LET THEIR DEVELOPMENT PROJECTS GET OUT OF HAND, WITH RESULT THEY ARE NOW BORROWING DESPITE LIMITED OFFICIAL USE

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PAGE 03 LONDON 04118 02 OF 03 161856Z

THEIR RICHES. BANKERS BELIEVE THIS DEVELOPMENT SALUTORY IN MAKING OTHER OPEC PRODUCERS MORE CAUTIOUS IN THEIR SPENDING PLANS. LONGER TERM OPEC DEPOSITS IN 3-5 YEAR MATURITY RANGE CONTINUE TO BE MADE. BUT TWO FAIRLY LARGE US BANKS REPORT SAUDI ARABIAN AND KUWAITI MATURITIES BEGINNING TO DECLINE AS YIELD CURVE FLATTENS WITH SHORT TERM RATES GOING UP; THEY CONSIDER INVESTMENT ADVICE CURRENTLY BEING GIVEN TO THESE COUNTRIES AS HIGHLY PROFESSIONAL AND ASTUTE, ALTHOUGH TECHNICAL AND COMMUNICATIONS PROBLEMS REMAIN AN IRRITANT. CONSIDERABLE OPEC DIVERSIFICATION REPORTED IN RECENT WEEKS INTO STRONGER CONTINENTAL CURRENCIES AND DOLLARS.

8. THE EUROBOND MARKET'S PHENOMENAL TAKE OFF DURING THE MONTH OF JANUARY, WITH TOTAL NEW ISSUES EXCEEDING TWO BILLION DOLLARS EQUIVALENT WAS NOT EXPECTED TO CONTINUE. THE SLOWDOWN IN ISSUES IN FEBRUARY IS SEEN AS A PERIOD OF EITHER DIGESTION OR INDIGESTION BUT WITH FIRM SECONDARY MARKET ACTIVITY AS LONG AS THE YIELD CURVE CONTINUES TO FAVOR INVESTMENT IN BONDS. UPTURN IN U.S. ECONOMY AND STRENGTHENING TONE OF SHORT-TERM INTEREST RATES IN THE US HAS RAISED SOME UNCERTAINTY AMONG MARKET OPERATORS ABOUT MARKET DURING SECOND HALF YEAR. THE MARKET IS TERMED STILL QUITE LIQUID AGAIN WITH GOOD NAME BORROWERS NOT HAVING DIFFICULTY OBTAINING FUNDS. CITY OF OSLO 20 MILLION DOLLAR ISSUE WITH 12-YEAR MATURITY OFFER IN LATE FEBRUARY CITED AS AN EXAMPLE. NONETHELESS, MOST CONSORTIA BANKERS STATE THAT MORE ATTENTION SHOULD BE PAID TO LENDING RISKS AND SOUNDNESS OF UNDERLYING OPERATIONS. SIZE OF EC BORROWING MAY REDUCE OR PREEMPT MARKET FOR A FEW WEEKS.

9. THE NARROWING OF SPREADS AND RATES IN EC'S LARGE OFFER

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PAGE 01 LONDON 04118 03 OF 03 161858Z

43

ACTION EUR-12

INFO OCT-01 EA-07 NEA-10 ISO-00 SP-02 USIA-06 AID-05 EB-07

NSC-05 CIEP-01 TRSE-00 SS-15 STR-04 OMB-01 CEA-01

CIAE-00 COME-00 FRB-03 INR-07 NSAE-00 XMB-02 OPIC-03

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LIMITED OFFICIAL USE SECTION 03 OF 03 LONDON 04118

INGS SCHEDULED TO BE OPENED NEXT WEEK HAVE NOT BEEN TOTALLY WELL RECEIVED BY US BANKS IN LONDON. THE 5-YEAR, 300 MILLION DOLLAR BULLET ISSUE WITH ONE PERCENT SPREAD OVER LIBO WAS OFFERED TO NINE LARGE US BANKS; FIVE AGREED TO PARTICIPATE (REPORTEDLY CHASE, BANKERS TRUST, MANUFACTURERS HANOVER, CONTINENTAL ILLINOIS AND MORGAN), THEIR MAXIMUM INVOLVEMENT WILL BE \$42 MILLION, MORGAN WITH \$10 AND EITHER \$7 OR \$8 MILLION EACH FROM THE OTHERS. THE OTHER FOUR US BANKS (CITY BANK, CHEMICAL, BANK OF AMERICA AND FIRST CHICAGO) CHOSE NOT TO ACCEPT THE TERMS OFFERED.
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PAGE 02 LONDON 04118 03 OF 03 161858Z

10. ONE SENIOR MARKET SOURCE SAYS THE EC'S \$300 MILLION, SIX YEAR, REPORTEDLY 8-1/4 TO 8-1/2 FIXED RATE ISSUE WILL BE SUCCESSFUL BECAUSE THE GERMAN BANKS ARE LEANING HEAVILY ON THE SWISS BANKS TO TAKE THE PAPER FOR THEIR DISCRETIONARY ACCOUNTS. UP TO HALF THE ISSUE MIGHT GO IN THIS MANNER, WITH BELGIAN DISCRETIONARY ACCOUNTS POSSIBLY TAKING ANOTHER 10 TO 15 PERCENT. THE ISSUE WILL BE PLACED, BUT WITH A RATE BELOW THAT FOR A TRIPLE A RATED BORROWER, THERE ARE BOUND TO BE MOANS AND GROANS, AND POSSIBLY SOME PRICE EFFECT IN THE SECONDARY MARKET.

11. SOURCES SPECULATE THAT THE DM PORTION OF THE EC ISSUE WILL BE AN AUTOMATIC SUCCESS, WITH GERMAN BANKS HAVING AN INFORMAL QUOTA ALLOCATION. THE PRIVATE PLACEMENT ASPECT OF THE OPERATION TO BE MADE IN APRIL, \$500 MILLION AT A REPORTED RATE IN 7-1/2 RANGE, MATURITY JUST UNDER 4 YEARS, MAY BE THE TOUGHEST TO PLACE. THE RATE BEING DISCUSSED IS LOW AND INSTITUTIONAL INVESTORS ARE UNLIKELY TO FIND IT ATTRACTIVE.

12. OTHER MATTERS BEING WATCHED CLOSELY HERE ARE PROGRESS OF US LEGISLATION AFFECTING FOREIGN BANKS IN US; EC COMMISSION PROPOSALS TO HARMONIZE DEPOSIT INSURANCE AND EXCHANGE OF CREDIT INFORMATION, WHICH SENIOR BANK OF ENGLAND OFFICIAL RECENTLY SAID SEEMED LIKE EC COMMISSION ATTEMPT TO FIND SOMETHING TO DO: AND UK'S OWN FORTHCOMING DRAFT BANKING LEGISLATION. SOME FORM OF ANNOUNCEMENT EXPECTED BEFORE EASTER. ALTHOUGH BANK OF ENGLAND OFFICIAL STATES IT WILL LARGELY BE A FORMALIZATION OF MUCH OF WHAT IS ALREADY REQUIRED FROM BANKS WITHOUT BENEFIT OF LEGISLATION.

13. AS IN PREVIOUS MESSAGES OF THIS TYPE, READERS SHOULD TAKE REPORTING WITH A GRAIN OF SALT. IT REPRESENTS VIEWS OF SENIOR AND KNOWLEDGEABLE BANKING OFFICIALS IN LONDON. BANKING OFFICIALS STRESS THAT SIMILAR INFORMATION IS AVAILABLE IN US AND OTHER EUROPEAN FINANCIAL CENTERS. NO ONE SEES THE ENTIRE PICTURE. THIS REPORT IS FINANCIAL ATTACHE'S BEST ESTIMATE OF THE SITUATION AS SEEN FROM LONDON.

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PAGE 03 LONDON 04118 03 OF 03 161858Z

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